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COMMENTARY**Guns, Butter and the War on Terror**By **CHRISTOPHER DEMUTH**

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Wartime can be bad times for economic policy. It's not just that military mobilization (and, this time around, elaborate homeland security measures) imposes heavy burdens on the private economy. The larger problem is that the political demands of war can cause government to grow across the board. This tendency has been conspicuous in the first years of the war on terror.

Since September 11, U.S. government spending and regulating *unrelated to the war on terror* have grown dramatically. Domestic discretionary non-security spending grew by 15% from 2001 through 2003 and will probably increase by more than 25% during President Bush's first term -- a much faster growth rate than at any time during the Clinton administration. Total federal spending now exceeds \$20,000 per household, the highest inflation-adjusted level since World War II. And it is bound to grow mightily as the baby-boom generation begins to cash in on Social Security and newly-expanded Medicare benefits. The December 2003 prescription-drug expansion of Medicare, the first major entitlement bill enacted without any taxes to pay for its benefits, adds at least \$10 trillion to the federal government's unfunded liabilities.


Government economic controls have also grown impressively. The deregulation movement, which since the late 1970s had steadily abolished New Deal-era regulatory controls, has yielded to a new era of re-regulation. Burdensome new regulations of the financial and energy sectors and of management-shareholder relations were imposed with bipartisan support following the Enron and other corporate scandals. A new independent agency has been created to regulate business accounting, with unilateral authority to set and collect taxes on all publicly held corporations. In the critical telecommunications sector, deregulation initiatives have been countermanded by Congress, and state and federal regulators are poised to restrict the growth of dynamic technologies such as Internet telephony. The new Medicare law extends federal regulation of the health-care sector in important respects (for example, banning the establishment of innovative specialty hospitals that compete with all-purpose academic hospitals), and will almost certainly lead to price controls on pharmaceuticals, just as the existing program led inexorably to price controls on hospital and physician services.

Finally, U.S. leadership in trade liberalization -- a bipartisan project since the early days of the Cold War -- has essentially collapsed. The Bush administration's most important trade initiatives have foundered amidst rancorous international disputes. All but one of the Democratic Party's 2004 presidential hopefuls (emphatically including John Kerry) have been adamant protectionists, a sharp departure from the free-trade policies of Democratic presidents from Bill Clinton on back. In response to populist attacks about "outsourcing," and the growth of the Chinese and Indian economies, the Bush White House has been quick to distance itself from officials who commit the gaffe of asserting the homeland benefits of free trade.

These developments have prompted some sharp criticisms of President Bush by his conservative supporters. Yet George Bush is, philosophically, a strong conservative and free-market man -- as are most of the members of the House of Representatives, which has collaborated in the surge in federal spending and regulating in vote after vote. In truth, government growth has resulted not from any change in Republican Party doctrine but rather from the necessities of political mobilization following the attacks of September 11.

Domestic spending and regulating are shaped by the pressures of innumerable interest groups -- representing

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farmers, teachers unions, business firms, veterans, environmental causes, etc. -- each extracting a subsidy here, a regulatory advantage there. The special-purpose congressional committees and administrative agencies are the friendly, accommodating forums for special interests. Asserting the public interest over the multitude of parochial claimants that collectively threaten it requires leadership from the top. Such leadership was essential to the tax reforms of 2001 and 2003, which required huge investments of President Bush's time and energy. But since September 11, the president and his senior officials have been preoccupied with other things. Other than the 2003 tax reform, Congress and the bureaucracies have mostly been left to their own devices.

And emergency mobilization is not merely distracting -- it requires positive accommodation of many individual legislators and constituencies. When the president has an urgent priority, such as a big appropriation for rebuilding Iraq, everyone in Washington knows it. To get what he needs, a president must acquiesce in much that he regards as incidental or even obnoxious. The price of necessary legislation includes the building of many unnecessary dams and other pork-barrel projects.

These developments are highly worrisome not only for our economic prospects but also for our prospects in the war on terror. As Princeton's Aaron Friedberg has shown, during our last period of extended security mobilization, the Cold War, America's "antistatist" political ethos -- our skepticism toward government and our preferences for personal freedom, low taxes, free trade and a growing consumer economy -- was critical in keeping pressures for government growth at bay. Presidents from Eisenhower to Kennedy to Reagan firmly resisted demands for economic regimentation and "military protectionism." The result was high rates of economic growth and technological innovation, and equally important capacities of social resilience and dynamism, that eventually overwhelmed the lumbering Soviet juggernaut.

The period of the late 1960s and 1970s was the exception that proved the utility of U.S. antistatism: The "guns and butter" policies of Presidents Johnson and Nixon, which combined the costs of a major foreign war with those of Great Society, Medicare and other spending and regulatory initiatives, contributed to a decade of high inflation, low growth, social division, declining military budgets and a succession of Communist victories. Then, of course, antistatism returned in full force in the 1980s with the election of Ronald Reagan; by decade's end, the Soviet Union was no more.

The first two years of the war on terror have again been a time of guns and butter -- not out of deliberate political calculation as during the Vietnam War, but as an unintended consequence of ad hoc accommodation to new political circumstances. The terrorist attacks were against American civilians on American soil, and much of the immediate response was the work of civilian authorities. This has generated popular appreciation for government in general: For the time being, American antistatism is in abeyance. At the same time, the threat of successive attacks has been relatively abstract and shrouded -- certainly as compared to the all-out war following Pearl Harbor and to the Cold War years when the Soviets and Chinese were regularly detonating nuclear weapons and invading neighboring nations. This has dulled the spirit of patriotic sacrifice that accompanied past mobilizations; indeed, government officials have exhorted Americans to continue traveling, shopping, and going about their business unintimidated by the terrorist threat. If citizens are to continue their peacetime consuming ways, why not Washington politicians and interest groups as well?

Yet the war on terror is different from anything we have faced before. It is a clash of civilizations, not economic systems, and it is likely to be long, nasty, and punctuated with harsh reversals. Organizations such as al Qaeda and Hezbollah, although socially and economically primitive, are nevertheless able to assimilate and deploy modern technology and organizational methods successfully. Unencumbered by the bureaucratic sloth and economic perversities of the Communist states, the most proficient terrorist groups are themselves fiendishly "market oriented" and entrepreneurial. They excel at informal contracting, joint venturing, extended networking, global financing and collaborating with friendly governments. In operations and tactics, they borrow from the West's civic and commercial freedoms with the purpose of undermining and eventually destroying those freedoms. And they possess, for the time being, an important intrinsic advantage: the technologies that now enable small, cohesive groups to execute surprise massacres of large numbers of people. Despite the Bush administration's energetic antiproliferation diplomacy, nuclear technology will almost certainly continue to spread.

Prevailing over such threats will require more than yet-undiscovered technological fixes. We also must be

prepared to maintain our morale, self-confidence and will to prevail. In response to a single attack claiming about 200 lives, Spain has already sued for peace. Britain, Italy, and Poland may be the next targets, and America could find itself friendless at key moments, even as we remain the ultimate target. Maintaining social morale is a complex and subtle thing, but a strong and growing economy is an important component. From Germany in the 1930s to America in the 1970s to Germany and France today, the worst cases of political decomposition have come at times of economic weakness. At a minimum, a robust, growing economy will be essential for financing a "generational commitment" (Condoleezza Rice's term) that will be largely ours to pay for.

These circumstances suggest a more profound relationship between economic policy and security policy. Our initial tactics have consisted of hunting down terrorist groups, reforming or replacing terror-supporting governments and, at home, imposing new government surveillance and controls over communications, transportation, finance and other aspects of commerce. These tactics, while essential, will almost certainly be less important over the long run than piling up our natural advantages -- our market-driven capacities for continuous innovation, spontaneous adaptation to changing circumstances and resilience in the face of unexpected reversals. And our success at promoting the institutions of political freedom and economic growth in the homelands of terrorism will depend to a significant degree on our maintaining those institutions in our own nations, both as exemplars and as engines of trade and economic power.

It is often said that the Islamist radicals hate America not for its sins but for its virtues -- the virtues of freedom, prosperity, and cultural dynamism. They fear as well as hate us for these virtues, and we should take them seriously. To the long list of good reasons for confronting the many wasteful and counterproductive policies that are holding our economy far below its potential, we may now add urgent reasons of national security.

Mr. DeMuth is president of the American Enterprise Institute. This essay is adapted from the June issue of The American Enterprise, which appears next week (taemag.com¹).

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